Supreme Court of the United States

October Term 1974

MICHAEL RODAK, JR., CLERK

No. 74-1138

ROLAND J. KALB and JEROME L. HEROLD,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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In The

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No.

ROLAND J. KALB and JEROME L. HEROLD,

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vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioners, Roland J. Kalb and Jerome L. Herold, petition for a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in this case on October 15, 1974.

OPINIONS BELOW

The opinion of the District Court (Appendix A, *infra,* 1a-20a) is not reported. The opinion of the Court of Appeals (Appendix C, *infra,* 24a-35a) is reported at 505 F.2d 506 (2 Cir. 1974).

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on October 15, 1974. A timely petition for rehearing was denied on December 12, 1974, and this petition for certiorari was filed within 90 days of that date.

Jurisdiction was conferred on the District Court by 28 U.S.C. Sections 1340, 1345 and 1355.

This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

Section 6672 of the Internal Revenue Code of 1954 imposes a penalty on *responsible* corporate officers who *willfully* fail to collect and pay over withholding taxes.

1. Can fines under the guise of being civil penalties of almost $200,000 constitutionally be imposed upon each of the petitioners without a jury trial where the petitioners had demanded a jury trial, had requested that the District Court Judge permit the case to go to the jury which had been impanelled and had heard nearly a week's testimony and where the petitioners had insisted in the Court of Appeals that they had been denied their rights under the Seventh Amendment to a jury trial? Can the petitioners' statutory right to a jury trial be denied under these circumstances?

2. Where the petitioners who were corporate officers had "reasonable cause" for the failure of the corporation to pay withholding taxes, can a fine of nearly $200,000 be levied against each of them for the corporation's failure? There is a split in the Circuits on this question.

3. Were the petitioners' statutory and constitutional rights to a jury trial negated by requiring them to prove their innocence?

4. Where the statute requires that a failure to pay must be "willful" and the company's lawyers and accountants are of the professional opinion that the taxes are not due, can each of the petitioners be subjected to a fine or civil penalty of almost

$200,000 for the failure of the company to pay withholding taxes? There is a split in the Circuits on this question.

5. Where a tax refund is due to a corporation and the corporation requests that the refund be applied to its withholding tax liability, is the government obligated to honor the request as any ordinary creditor would be or are there special rules applicable to the government even though Congress has not seen fit to legislate any such special rules?

6. Can a penalty be imposed without constitutional safeguards applicable to criminal cases when the penalty is nearly twenty times the maximum criminal fine for the same acts and where the penalty is punitive rather than compensatory?

7. May the Internal Revenue Service assess penalties against the petitioners where the revenue is not in jeopardy without regard to the petitioners' constitutional rights to due process and where the *ex parte* assessment by the Internal Revenue Service has a significant impact upon the petitioners' constitutional and statutory rights?

CONSTITUTIONAL PROVISION INVOLVED

AMENDMENT VII — CIVIL TRIALS

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

STATUTES INVOLVED

The pertinent provisions of Sections 6201, 6203, 6321, 6671 and 6672 of the Internal Revenue Code of 1954 are set forth at Appendix F, *infra,* 41a-45a.

STATEMENT OF THE CASE

The petitioners are two elderly men upon whom penalties of nearly $200,000 *each* have been imposed. Since the Internal Revenue Service contends that these Draconian penalties are not dischargeable in bankruptcy, the decisions of the Internal Revenue Service and the Courts below constitute, in effect, lifetime sentences at hard labor. The gross injustices were imposed despite petitioners' unavailing plea that they were entitled to a jury trial. The District Court required the petitioners to prove their innocence and thus, in effect, rubber stamped an *ex parte* administrative determination of the Internal Revenue Service and imposed penalties upon each of the petitioners of $199,630.87. The Court of Appeals affirmed.

A. Factual Background

In the late 1950's, the petitioners were officers, directors and principal stockholders of Herold Radio & Electronics Company ("Herold Radio") of Mount Vernon, New York. The company employed over 800 people. Mr. Kalb was the Chairman of the Board and Chief Executive Officer and Mr. Herold was President.

In 1959 the company's financial condition began to deteriorate. The Bankers Trust Company, which had provided financing for the business, threatened to withdraw its line of credit. Mr. Kalb, for the company, and Bankers Trust Company reached an agreement whereby financing continued on the condition that the bank was permitted to place a representative on Herold Radio's premises to oversee the company's financial operations.

The efforts to save Herold Radio failed. In January 1961 the company ceased operations with $163,613.35 in withholding taxes unpaid.

At the time the company had an income tax refund due to it as a result of a net operating loss for the year 1960 which it asked the Internal Revenue Service to apply to the unpaid withholding taxes. Both the company's lawyers and accountants were of the opinion that the refund would be so applied and wipe out the withholding tax liability. Contrary to explicit directions for the application of the refund to the withholding tax liability, the Internal Revenue Service applied the refund instead to excise taxes.

B. Administrative Action

In April, 1969, nearly ten years after the debacle, the Internal Revenue Service assessed a penalty of $163,613.35 against each petitioner pursuant to Section 6672.[1]

C. District Court Action

Mr. Kalb paid part of the assessment and then commenced an action in the United States District Court for the Southern District of New York for a refund of the payment. The United States counterclaimed for the unpaid part of the assessment. Later the United States commenced a third-party action against Mr. Herold. Mr. Herold had moved to Florida and had lived there for many years before the action was commenced against him in the Southern District of New York. Mr. Herold counterclaimed for his partial payment of the assessment.

In a move more reminiscent of Kafka than the Constitution, the District Court ruled that the petitioners had the burden of proving their innocence.[2]

Both petitioners demanded a jury trial and the case was brought on for trial before a jury. After four full days of jury

1. Unlike the situation in income tax cases, there is no prohibition against assessment pending determination of liability because the Tax Court has not been given jurisdiction over 100% penalties. Yudkin, "Corporate Officers in Increasing Numbers Face Penalties for Defaults on Withholding Tax", 18 The Journal of Taxation, 248 (April 1963).

2. This result was particularly harsh for Mr. Herold who would never have been in a court one thousand miles from his home if Mr. Kalb had not commenced a refund action in New York.

trial and *minutes* before the government was to finish its case, the District Judge directed a verdict in favor of the government. The case was taken from the jury and a judgment entered against *each* petitioner in the amount of $199,630.87 constituting the amount originally assessed by the Internal Revenue Service plus interest.

Section 6672 requires that the person against whom the 100% penalty is assessed be a *responsible* person and that such person's actions be *willful*. The issues were, thus, strictly factual. Mr. Kalb's principal factual contention was that Bankers Trust Company was holding the pursestrings and therefore that he was neither responsible nor were his actions willful. The Courts below rejected the defense that Bankers Trust Company, in effect, controlled the finances of Herold Radio. While the Courts below may have been skeptical of this defense, Congress has been more realistic. Section 3505 of the Internal Revenue Code relating to wages after January 1, 1967 was enacted to cover exactly such a situation.

The Court of Appeals made one serious factual mistake which led to a number of errors in its decision. The Court found — completely without support in the record below — that the company had (a) withheld taxes from its employees, (b) was holding funds which belonged to the government and (c) was holding "trust funds". *In fact, there never were any such taxes or trust funds*!!, the District Court Judge so found (6a).

In simplified version here is what happened: The company was almost constantly overdrawn at Bankers Trust Company. Bankers Trust was providing current operating funds

so that the company could work off its loan — which it did to a large extent. When a payroll was due, Bankers Trust would permit the company to write checks for the net amount due to the employees, notwithstanding the fact that there were insufficient funds in the company's account. When the checks were presented for payment, the bank cleared only those checks its officer on the company's premises had previously authorized. Bankers Trust was advancing only net payroll and not the gross payroll. For example, assume the company bank account was overdrawn $1,500 and there was a gross payroll due of $10,000 consisting of $7,500 due to the employees and $2,500 in withholding taxes. The Bankers Trust officer would permit the company to write checks for the $7,500 which would increase the company's overdraft by that amount up to $9,000. The resulting $9,000 overdraft was either added to the company's loan or paid down by cash receipts. The $2,500 which loomed so large in the consideration of the Court below simply never existed. The factual defenses should have gone to the jury.

Mr. Herold's principal defenses were also factual. He contended that he did not know anything about taxes and finance. Mr. Herold claimed that he was president "in name only", and even that title was an accident of corporate history.

D. Court of Appeals

The Court of Appeals affirmed the factual determination that both petitioners were responsible officers and agreed with the District Judge's finding that Mr. Kalb's actions were willful.[3]

3. The Court of Appeals remanded as to Mr. Herold on the issue of willfulness. The scope of the remand is so limited that it would almost support a jury charge that Mr. Herold's actions were willful if he "should have known", 505 F.2d at 511. This result, *(Cont'd)*

REASONS FOR GRANTING THE WRIT

A. The petitioners were denied their right to jury trial under the Seventh Amendment to the Constitution. By directing a verdict, the District Court took the case away from the jury.

> "Maintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care." *Dimick v. Schiedt,* 293 U.S. 474, 486.

See Stern and Gressman, Supreme Court Practice, Fourth Edition, BNA, 1969, p. 175.

Procedurally, taking the case away from the jury minutes before the conclusion of the trial was contrary to the frequent injunction to District Courts to permit partially tried cases to go to the jury rather than to cause the time, trouble and expense of a new trial if the District Judge is wrong on the law, *Lindeman v. Textron, Incorporated,* 229 F.2d 273 (2 Cir. 1956).

Substantively, the result of taking the case from the jury was to penalize each of the petitioners almost $200,000 without

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(Cont'd)

too, is wrong. Since the issues as to both petitioners are largely the same, this Court should grant the writ as to both despite the fact that technically Mr. Herold prevailed in the Court below. Since (a) the government by practice and policy "packages" these cases as it did this one (Rev. Proc. 69-26, 1969-2 C.B. 308), (b) the results might otherwise be inconsistent, and (c) there will be a saving in judicial time and expenses of litigation, petitioners submit that certiorari should be granted as to both at this time.

the concurrence of a jury of their peers *and* to do so on a basis which required them to prove their innocence. There are two substantive bases for granting the writ on the ground that petitioners should have had a jury trial.

(1) Certiorari should be granted because the result is "shockingly wrong", Stern and Gressman, *op. cit.*, p. 173.

(2) Regardless of the nature of the action below or its peculiar procedural posture as far as Mr. Herold was concerned, the petitioners were constitutionally and statutorily entitled to the judgment of a jury. If this case is treated as a tax refund action there is a statutory right to jury trial (28 U.S.C. §2402). If it is treated as a penalty action there is a constitutional right to jury trial (*United States v. J. B. Williams Company, Inc.*, 498 F.2d 414 (2 Cir. 1974)).

B. There is a split in the circuits as to whether a corporate officer is liable under Section 6672 where there is "reasonable cause" for the failure to pay withholding taxes. This split of authority was explicitly recognized by the Court of Appeals below (505 F.2d at 509) citing *Newsome v. United States*, 431 F.2d 742 (5 Cir. 1970) and *Monday v. United States*, 421 F.2d 1210 (7 Cir. 1970), *cert. denied*, 400 U.S. 821 (1970). The overpayment arising from the company's net operating loss, coupled with the specific request by the company for application of the overpayment to the withholding taxes should exonerate the petitioners because they establish reasonable cause for the failure. The rule should be the same in the Second, Fifth and Seventh Circuits.

The issues raised in this petition are of sufficient general importance to warrant a full review by this Court. See Crampton, "The 100 Percent Penalty on a Responsible Officer", N.Y.U. 21st Institute on Federal Taxation 117 (1963); Loo and Krasne, "Take the Money and Run: An Assessment of the 100 Per Cent Penalty", 51 Taxes, *The Tax Magazine*, 29 (January 1973); Scott, "One Hundred Percent Employment Tax Penalty: An Analysis of IRC §6672", 10 Washburn Law Journal 1 (1970); Yudkin "Corporate Officers in Increasing Numbers Face Penalties for Defaults on Withholding Tax", 18 The Journal of Taxation, 248 (April 1963); and a very comprehensive annotation which runs 275 pages entitled "Withholding Taxes — Penalties" in 22 A.L.R. 3d 8.

As subsidiary matter it should be noted that the overpayment and request for application to withholding taxes negate willfulness.

C. There is now a split in the circuits as to whether professional legal and accounting advice provides evidence of non-willfulness in Section 6672. The attorneys for Herold Radio and the independent certified public accountants both were of the professional opinion that the withholding taxes in question were taken care of by the overpayment of income taxes which resulted from the company's net operating loss in 1960.[4] The result below is contrary to *Gray Line Co. v. Granquist*, 237 F.2d 390 (9 Cir. 1956), *cert. denied*, 353 U.S. 911 (1957), which held that such a penalty could not be imposed where the failure to

4. This issue was raised in the Court below and not covered in its opinion. It was a principal point raised in the joint petition for rehearing which was denied without opinion.

pay is based upon advice of counsel that the taxes are not due. Until now the cases have uniformly held that a corporate officer will be exonerated where he relies on the advice of attorneys and accountants. *Educational Fund of Electrical Industry v. United States,* 305 F. Supp. 317 (S.D.N.Y. 1969), *aff'd,* 426 F.2d 1053 (2 Cir. 1970); *Haywood Lumber & Mining Co. v. Commissioner of Internal Revenue,* 178 F.2d 769 (2 Cir. 1950) and *Newsome v. United States,* 301 F. Supp. 757 (S.D. Tex. 1968).

D. The overpayment should have been applied in accordance with the request. The Court below erred in applying different rules to a taxpayer who is in debt to the government than those prevailing in the ordinary debtor-creditor relationship. The Internal Revenue Code does not direct such different treatment nor is there any congressional edict depriving the taxpayers of this fundamental debtor right to direct the application of payment. The general debtor and creditor rules must therefore prevail. 10 Mertens, *The Law of Federal Income Taxation,* Sec. 58.27 (1970 Ed.).

E. As a separate and distinct basis for granting the writ, we respectfully submit that the penalty provided for in Section 6672 as applied *in this case* is so closely akin to a criminal fine that the petitioners should have been given the rights afforded to criminal defendants under the Constitution, including a right to trial by jury under the Sixth Amendment. The penalty imposed on these two old men is so horrendous and so far out of proportion to the magnitude of the wrong they committed, if any, as to require constitutional safeguards. The judgment below is almost *twenty* times the maximum criminal fine for the same acts!! The maximum fine under Section 7215 is $5,000 and that

section was enacted in 1958 specifically to cope with the withholding tax problem. Senate Report No. 1182, 85th Cong. 2d Sess. (1958) in U.S. Cong. & Adm. News 2187. See *Penfield Co. v. SEC*, 330 U.S. 585 (1947) and *Trop v. Dulles*, 356 U.S. 86 (1958).

The evidence that Section 6672 is penal is substantial. See Scott, "One Hundred Percent Employment Tax Penalty: An Analysis of IRC §6672", 10 Washburn Law Journal 1, 13 (1970). First, the section itself indicates that it is a "penalty". The section is contained in a sub-chapter of the Internal Revenue Code entitled "Assessable Penalties". Penalty according to any dictionary connotes "punishment".

Second, where several persons are charged with the duty to collect, account for and pay over a tax and fail to do so, the penalty may be, and usually is, assessed against all such persons in the full amount of the tax. Rev. Proc. 69-26, 1969-2 Cum. Bull. 308. The fact that the penalty is assessed against a number of people is consistent with a penal statute and inconsistent with a tax statute.

Third, the penalty, if paid, is not deductible on the person's own tax return as a matter of public policy. *Benjamin T. Smith*, 34 TC 1100 (1960), *aff'd*, 294 F.2d 957 (5 Cir. 1961). See also Section 162(f) which was added by the Tax Reform Act of 1969. Business taxes are deductible, criminal fines are not.

Fourth, since the Section 6672 penalties can be collected from any number of persons and the corporation nevertheless remains liable for the taxes, the statute is obviously punitive and not compensatory.

Fifth, the Internal Revenue Service has recognized the obvious infirmity in the statute and therefore, as a matter of administrative largesse, has adopted a policy of collecting the tax or penalty only once, I.R. Mim. No. 5646, dated April 9, 1956. *Spivak v. United States,* 254 F. Supp. 517 (S.D.N.Y. 1966), *aff'd,* 370 F.2d 612 (2 Cir. 1967), *cert. denied,* 387 U.S. 908 (1967) and *McCarty v. United States,* 437 F.2d 961 (Ct. Cl. 1971). Administrative largesse, once granted, can be withheld as it was in *United States v. Mr. Hamburg Bronx Corp.,* 228 F. Supp. 115 (S.D.N.Y. 1964).

Sixth, another piece of evidence that the statute is penal is found in the practice of the Internal Revenue Service of not assessing the penalty against an active general partner because he is already individually liable for the tax by virtue of his partnership status. *In re Crockett,* 150 F. Supp. 352 (N.D. Cal. 1957); *Young v. Riddell,* 283 F.2d 909 (9 Cir. 1960), Yudkin, "Corporate Officers in Increasing Numbers Face Penalties for Defaults on Withholding Tax", 18 The Journal of Taxation 248, 249 (April 1963). If the statute were not penal the Internal Revenue Service would not voluntarily restrict its statutory prerogatives. Citizens in the United States are entitled to constitutional protection and need not rely upon administrative whims.

Seventh, the government contends that the Section 6672 penalty is not dischargeable in bankruptcy. With exceptions not pertinent here, taxes are dischargeable. Section 17 of the Bankruptcy Act, 11 U.S.C. §35.

The Draconian nature of Section 6672 was explicitly recognized by Judge Nichols of the United States Court of

Claims in *McCarty v. United States*, 437 F.2d 961 (Ct. Cl. 1971). Judge Nichols said at 437 F.2d 974:

> "The Congress can enact a statute that appears in unambiguous language to assess Draconic penalties for actions, some of which may be quite innocent, but it can count on the executive and judicial branches to take note of what it really meant to accomplish and exclude the law from application to cases not within congressional contemplation." [5]

Section 6672 has all of the earmarks of a penal statute. *Congress called the wolf a lamb.*

The contention that Section 6672 is a penal provision was rejected by the Court below (505 F.2d at 510) and by the Seventh Circuit in *Monday v. United States*, 421 F.2d 1210 (7 Cir. 1970), *cert. denied*, 400 U.S. 821 (1970).

F. Finally, certiorari should be granted because the assessment procedure [6] with respect to Section 6672 is unconstitutional generally and as applied in this case.

First, and with due respect to the Court below, this is not a matter of jeopardy assessment within the exception noted in

5. The harshness of the civil penalties has been ameliorated somewhat in the context of the False Claims Act, 31 U.S.C. §231, where the government has the burden of proof by "clear, unequivocal and convincing evidence". *United States v. Ueber*, 299 F.2d 310 (6 Cir. 1962).

6. The assessment procedure is described in detail in Yudkin, "Corporate Officers in Increasing Numbers Face Penalties for Defaults on Withholding Tax", 18 The Journal of Taxation, 248-249 (April 1963).

footnote 24 to the *Fuentes v. Shevin* opinion at 407 U.S. 67, 92 (1972). There is no overwhelming immediate government interest in this case. The United States of America is not going to stand or fall on the $620.39 which was seized from Mr. Herold and for which he claimed a refund. Mr. Herold is over 60 years of age and a regular full-time employee of the Martin Marietta Company. He lives and works in Orlando, Florida. The underlying taxes relate to the 1959-1960 period — 15 years ago. In short, this case does not amount to a hill of beans as far as time is concerned. There is no conceivable reason why the Internal Revenue Service needed to assess and collect the Section 6672 penalty on what was, in effect, a jeopardy basis.

Even the scope of the government's rights under the jeopardy assessment rules are being challenged and are currently before this Court in *James Burnett McKay Laing v. United States, et al.*, 73-1808 and *United States, et al. v. Elizabeth Jane Hall*, 74-75 (consolidated; argued January, 1975; decision pending) and *United States v. Rambo*, 73-2005.

Second, the petitioners were not permitted to challenge the assessment in the Tax Court before the assessment was made[7] and could not go into the District Court *(Enochs v. Williams Packing Co.*, 370 U.S. 1 (1962)) before the assessment. The assessment in this case was done administratively, *ex parte* and prior to any judicial review. The assessment had a *substantial* impact upon the petitioners' legal rights. Thus, and among other things, the District Court gave the assessment *prima facie*

7. The Tax Court is not available to corporate officers facing Section 6672 assessments. See Yudkin, "Corporate Officers in Increasing Numbers Face Penalties for Default on Withholding Taxes", 18 The Journal of Taxation, 248 (April 1963).

validity[8] and imposed the burden of proof of non-liability upon the petitioners. The end result of the assessment was to deny a jury trial to petitioners.

This Court has been careful to protect property rights from interference unless there are judicial safeguards. *Sniadach v. Family Finance Corp.*, 395 U.S. 337 (1969); *Fuentes v. Shevin*, 407 U.S. 67 (1972); *North Georgia Finishing, Inc. v. Di-Chem, Inc.*, 43 L.W. 4192 (January 27, 1975).

Constitutional rights — Seventh Amendment rights to be specific — should be even more sacred than property rights.

The assessments also affected petitioners' property rights since an assessment has the effect of a judgment *(Bull v. United States*, 295 U.S. 247 (1935)), and thus constitutes a lien on petitioners' property and permits summary seizure.

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8. In doing so the District Court was following the decision of the Second Circuit in the *United States v. Lease*, 346 F.2d 696 (2 Cir. 1965). The *Lease* case did *not* involve a Section 6672 penalty.

CONCLUSION

For the foregoing reasons the petition for writ of certiorari to the United States Court of Appeals for the Second Circuit should be granted.

March 7, 1975

Respectfully submitted,

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Of Counsel

APPENDIX A

[Commencing at page 692]

ROLAND J. KALB
vs.
UNITED STATES OF AMERICA
vs.
MORRIS STEELMAN and
JEROME L. HEROLD. 70 Civ. 5726

New York, May 25, 1973;
10:00 o'clock a.m.

(Trial resumed.)

— —

(Jury not present.)

THE COURT: First I will pass upon the matter of the refund. The sole question now is whether or not I should in any way alter my previous decision. Two of the parties here, Kalb and Herold, apparently contend that the prospective corporate tax refund carryover from Herold Radio & Electronics Corporation should have been applied to the Internal Revenue Service claim on FICA taxes and withholding tax liabilities in question. I have concluded that this claim is without merit or support.

The authority for the Commission of Internal Revenue to apply overpayment of prior taxable periods to tax liability is

found in Section 6402(A)1, Internal Revenue Code, 1954. The general rule of claim in the nature of a tax refund should not be applied to create an unjust enrichment in favor of taxpayer at the expense of the [693] Government.

Fisher v. CIR, 108 Fed. 2d 707, Cert. denied 310 U.S. 627, 1940.

Moreover, irrespective of the foregoing the Government has the right to determine for itself by law and by proper regulations which have the force of law the conditions upon which it consents to the refund of taxes; Tennessee Consolidated Coal Company against CIR, 117 Fed. 2d 452, Sixth Circuit, 1941.

See also Herich against the United States, 34 Fed. Supp. 283, Northern District of Illinois.

The Government has even been permitted to apply tax refunds and credits against a tax deficiency which had been barred by the statute of limitations. This was held to be a right to credit refunds against any tax and the taxpayer could not designate the credit against any particular tax. The matter of Griffiths Manufacturing Company, Inc., bankrupt, 42-2, USTC, 9646. The Sixth Circuit also supported this position in Monday against United States, 421 Fed. 2d 1212.

The Court of Appeals there permitted the IRS to apply the refund is deemed appropriate and any proof that there is any administrative practice otherwise, and an earlier decision even more restrictive in its holding [694] refused to permit an amount

specifically paid to the Government in a bankruptcy arrangement proceeding as a dividend pending the Government claim for tax deficiencies arising from failure of responsible officer of the corporation to pay over Federal income taxes, FICA contributions withheld from wages of corporate employees. Horowitz against U.S. 339, Fed. 2d 877, Second Circuit, 1965.

In conclusion no authority has been called to my attention, nor have I found any, which would sustain the position of either Kalb or Herold with respect to this refund claim. This claim on their behalf if allowed would amount to a grant to any corporation to omit payment of current FICA taxes merely because the corporation might at some future time possibly receive a refund in respect to certain taxes previously paid in. No Government can operate financially on such a basis. Hence, I decline to alter my previous rulings in respect to this proof.

Now I come to a consideration of the motions made by the Government with respect to the claims of Kalb and Herold in this action. I shall recite substantially the facts as they were submitted.

I first treat the testimony of Kalb and I shall give after some of these statements the pages in the tran-[695]script where this particular proof appears. It relates to the background.

Herold Radio & Electronics Corporation began in 1957 and the annual business done was $10 million. 5.

Appendix A

Kalb delved in marketing, sales, manufacturing, engineering and product design. 6.

In September 1959 the company needed working capital. 8.

Bankers Trust Company notified the company of its intention to withdraw the banking arrangement. 9.

The company owed Bankers Trust Company a little under $2 million. 9.

This banking arrangement was based on accounts receivable financing, financing of finished goods and raw materials and inventory financing. Page 10.

80 per cent was paid on assignment, 20 per cent at the time of payment. 11.

This was somewhat modified by the testimony of Mr. Tappen from the bank, 50 per cent against goods on raw materials and subassemblies subject to the modification I stated.

Now, in September 1959, as a result of a letter, I believe it was Exhibit 1, submitted by Kalb on behalf of the corporation to the bank, the Bankers Trust Company installed a representative on the premises of Herold.

[696] Under this arrangement Orlin for the bank appeared and DeBlazio and Gavin appeared and were delegated to that work by the bank.

Appendix A

In the beginning of 1960 Kalb had conversations with Tappen and with Orlin. Page 24.

Tappen said that Orlin was to be present full time — this is Kalb's testimony — "To evaluate the financial condition and to make sure that no expenditures are being authorized without his agreement." Page 26.

DeBlazio laid down the necessity of like approval, so Kalb said, in similar conversations with Gavin. Pages 27, 28.

Kalb knew that the taxes were due and past due. Page 30.

Petition of the company for reorganization was filed, I believe, on August 15, 1960. Page 31.

Permission was granted for the debtor, that is this company, to remain in possession and hence to continue the business. Pages 31, 32.

Kalb stated a daily list of creditors was prepared or obtained from Freedland's division and submitted the same to the bank's representatives. Page 34.

Kalb became aware of the company's unpaid taxes. Page 34. And he asked the bank to authorize, so he said, [697] the issuance of a check to pay the taxes. Page 35. But the bank refused. Page 36.

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There is some division of testimony on that, at least by Tappen, but I am taking Kalb's statement. The bank refused, as I have said. Page 36.

Herold Radio received money from Bankers Trust Company for receivables in the fourth quarter of 1959. Page 37. Similar proceedings occurred in subsequent quarters, according to Kalb, with similar refusals by the bank to pay. Pages 40, 41, 42.

From time to time, according to Kalb, the bank advanced money for net payrolls. Pages 43 and 44. This continued between July 1, 1960, and August 14, 1960, and in the first quarter of 1961. Page 45.

There is, of course, some division of proof as to that and Tappen said that apparently — I judge from what he testified to — there was no indication on the papers submitted.

I say that there was some division of statement as to whether or not the requisition from the company which passed through the representative of the bank stated that this was net or gross as far as the taxation was concerned. In my view of the case it makes no difference.

During the fourth quarter of 1959 Herold Radio [698] had no money in its account except that advanced by the bank. Likewise, for the first and second quarters of 1960 and for the period from July 1, 1960, through August 14, 1960. Pages 46 and 47.

Appendix A

Now, in 1950 when these corporations were formed the stock of Herold at least was divided about equally among Kalb, Steelman and Herold. Page 51.

In August, 1960, the company went into an arrangment for reorganization. Pages 51 and 52.

Prior to June, 1957 — I believe in 1955 or 1957 the stock holdings of the three individuals, Kalb, Herold and Steelman were diluted by a public sale. Pages 52 and 53.

At that time Kalb, Steelman and Herold were directors. In fact, at all times. Page 54. Kalb was also chairman of the board at all times. In June, 1960, before this dilution, Kalb held 12.44 per cent of the stock or 68,810 shares. Page 55. Herold had 73,700 shares. Page 55 and 56. Steelman had 82, 946 shares. Page 56. Any two of the three could sign checks. Pages 56 and 57.

There was the payroll account in the County Trust Company, Mount Vernon branch. Page 57. And the same arrangement was made with respect to checks there. Page 58. Any two of the officers, Kalb, Steelman and Herold, continued [699] to sign the company checks until the company ceased to do business. Pages 62 and 63. Salaries were paid in this period to Kalb, Steelman and Herold. Pages 66 and 67.

Freedland was in charge of the preparation of the checks. Page 68. And then the bank approved the list, indicating yes or no on the list itself. Page 69.

Appendix A

Kalb declared that he orally protested to the bank's representatives to pay the taxes. Page 73. All three of the executives had their office at the Yonkers plant after the fall of 1959. Page 78.

The board of directors, and Kalb, at their meetings discussed the situation with respect to the payment of taxes while Steelman and Herold were present. Page 94.

Kalb knew that the company was short of cash and did not have enough to pay all of its bills in order to keep the company from going out of business, although there were some creditors submitting bills he thought could be put off. Pages 181, 182.

At the time of the writing of this request to the bank to perform in the way they ultimately did the company owed the bank somewhat under $2,000,000. Page 182. And during the period from January 25, 1960, at the time of the bankruptcy, the bank was being paid something on account during the entire period. Page 182. At the time [700] of the bankruptcy the loan was down to $400,000. Page 183.

The original notification from the bank stating that it wanted to terminate the financing agreement had been submitted some time in September, 1959. Pages 186, 187.

Kalb's salary during this period was $15,000 annually. Some time in September, 1959, the officers of the company guaranteed with their stock certain specific loans to the corporation. I believe one of these was by some company the exact name of

which I do not remember, and then there was a loan from Jones & Company, according to Kalb, and I believe this was later confirmed by Tappen, if I'm not mistaken. The checks which were received by the company for supplies were endorsed over to the Bankers Trust Company and were not placed in the company's account at Bankers Trust. Page 225.

Now, the letter from Kalb to the bank, I believe it is Exhibit 1, and the subsequent acquiescence of Kalb and Herold in the bank's control of the corporation payments was a self-inflicted imposition on Herold Radio. The subsequent preferences of payments of various creditors of Herold Radio, including Bankers Trust Company, combined with the non-payment of taxes due to the United States was [701] a basic concept in connection with the failure to pay the quarterly taxes thereunder.

Another feature of this arrangement was that the individuals, Herold, Kalb and Steelman, guaranteed at all times the complete payment of the loans made by Bankers Trust in the manner which I have suggested. So much for the background and the general facts with respect to Kalb.

Now I turn to Herold. He now works for another company and he described his education. In 1949 or 1950, together with Kalb and Steelman, three companies were established. Pages 389, 390. One was Herold Radio and Electronics, the second one was Steelman Phonograph and Radio and the third, named after Kalb, was Roland Radio. Kalb's name, as I understood, was Roland. Herold was president of Herold, Steelman of Steelman

and Kalb of Roland, and the stock was divided about equally. In other words, that is the issued stock. Page 390.

First these companies were run separately but later as one company, the change being made in 1950.

Herold said that the lawyer for the company and the Certified Public Accountants were hired by Kalb. And then in 1950 came the public issuance of stock which made it so that the public held a large proportion of the [702] stock. I don't know the exact percentage. It did appear in the record.

The controller and Kalb were charged with this offering. Herold, Steelman and Kalb each put up stock. This stock issue came from the company's stock and the proceeds went into the corporate treasury. Pages 396 and 397.

Herold testified that his salary was charged to the purchasing department account, page 400, Kalb's to the management account, page 401, and that this allocation continued after February 28, 1958, Page 404.

Herold was president of this company and was authorized to sign checks and did sign checks from time to time including the period while the bank had its representative at the plan. Page 404.

There were a number of checks submitted into evidence and it demonstrated, of course, that Herold was at least almost continuously signing some checks. Herold declared that he did

not receive a copy of Exhibit E, dated May 11, 1959. I believe that was the notice to the bank. Page 407.

After May 11, 1959, Herold said that the policy was that all checks had to be approved by Kalb and that this continued to the time of the bankruptcy. Page 409. [703] He mentioned, that is Harold mentioned strikes in the summer of 1959 with some unions but which did not affect the company directly but affected the purchase of their supplies. The last three months of 1959 and continuing through a portion of 1961 Herold said he had certain conversations with Kalb in which Herold said he questioned Kalb about the receipt of shipments from this vendor or that and Kalb answered "I will put it on the list," apparently referring to payments to the suppliers. Page 421. Similar conversations Herold said were held with Freedland. Pages 422 and 423.

Herold denied having any dealings with DeBlazio while DeBlazio was stationed at the company. He met Mr. Gavin. Herold asked about shipments from certain vendors and so forth. Gavin answered that he would take it up with his superior and send it to the bank. Pages 425 and 426.

When there were questions about the payments of supplies purchased by Herold Radio, Herold said he took it up with the accounting department. Page 430. However, the normal accounts payable went through the department, he said, apparently in some instances without supervision by him. If there were some questions he determined them. Sometimes he would go to Freedland about the matter or to Kalb and one or the other would go to the bank. Page 433.

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[704] Herold signed checks to the suppliers. He signed many checks but he said he does not know anything about the amount of the company's assets in cash, page 434, although he inquired at times but he never considered whether there was enough money. Page 435.

He stated that he recalled no conversations with Gavin or Tappen or with anyone in the period between October, 1959, through November of 1961 in respect to holding companies. He also stated that he did not know about it. Pages 466 and 467.

Cross-examination of Herold by Mr. Eisenstat elicited in part the following: Subsequent to May 11, 1959, he signed certain checks of the corporation. Pages 456, 457. You will also recall that there were a substantial number of checks which he had signed admitted into evidence. Herold conceded that he knew that subsequent to December, I believe it was, of 1959 that the bank controlled all of the financing and payments of Herold Radio. Pages 458, 459.

Now, in connection with these loans, as I think I stated before in connection with the loan by Jones & Company to Herold Radio, the three officers pledged all their stock in connection with the loans from the Bankers Trust Company likewise. He referred to the stock offering in [705] 1955 and I believe there was another one in 1957 presumably approved by the board of directors and authorized by the board of directors when Herold was present. This, of course, meant that the company had become public and that there were other stockholders besides Kalb, Steelman and Herold whose rights

should have been respected. Also Herold conceded that he was a member of a so-called management committee of this Herold Radio Company from 1958 to 1959. Page 468. Steelman was also a member. The management committee had meetings attended by him although he said he could not recall discussion of financial affairs, but the management committee, he agreed, did discuss dividends.

There was also a trust agreement in which all three of these persons were parties. Pages 471, 472.

At some time prior to February, 1960, there was an occasion of the borrowing from the Prudential Small Business Investing Corporation by the three to provide funds to the company in the amount of $75,000. Pages 472-474.

Herold said he had approximately six to twelve meetings with Gavin, a representative of the bank, on the premises. At these meetings payment of vendors was discussed. Herold also conceded that he saw some of the [706] list of creditors who were scheduled for checks and that he looked over the lists and that there was indication on them as to who was to be paid and who was not to be paid. He likewise admitted that in July, 1960, he personally signed a withholding tax return of the company and that he signed other returns. Pages 485, 486.

In spite of the nature of the verification on the paper he said he made no attempt to verify the accuracy of the return before he signed it, relying on somebody else. He also conceded that during 1960, Herold, that he signed certain checks payable to

Internal Revenue Service. Page 491. Sometimes checks slipped through by mistake and it was found later that only one of two officers had signed and the bank would call and get some verification as to the second signature. Page 492.

Herold signed Exhibit BL, a check to the IRS in the sum of $66,008.03. Page 495. And he described the so-called freight account at the First National City Bank and explained how it was used and it was indicated from the records that he signed various of these checks.

[707] County Trust Company was used for payroll purposes he said and signed certain of these checks (499 through 505). Other checks were signed (506, 509).

During the fourth quarter of 1959 Herold Radio maintained a payroll account at Bankers Trust (509). Checks were written on this account. Herold signed some of those checks as well as Steelman and Kalb (510 and 516).

As I said, he signed them to the IRS.

I think it may be said without contradiction that no corporation has the right to abjure the obligation to pay the corporate taxes to the United States or to ascertain if they have been paid and no officer has the privilege of protection by any artificial budgeting allocation or method of charging the respective salaries of officers concerned.

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The fact that these officers, including Herold, had the right to sign checks is significant. The fact that Herold frequently was one of the two officers who signed is also noteworthy.

Of course, the statute is clear, Section 6672, Internal Revenue Code 1954 provides:

> "Any person required to collect, truthfully account for and pay over any tax imposed by the [708] title or wilfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded if not collected or not accounted for and paid over. No penalty shall be imposed under Section 6653 for any offense to which this section is applicable."

Now, obviously, it appears from this entire record, and speaking now of Herold, that Herold fully acquiesced in the bank's control. Furthermore, his allegation that he had nothing to do with the business of the corporation with respect to finances or taxes is overwhelmed by the various actions which I have already recited.

Of course, it is fundamental that the plaintiffs here or the persons alleged to have been the responsible officers have the burden of proving that the Commissioner's determination was erroneous and their conduct was not wilful.

Appendix A

United States v. Strebler, 313 F.2d 402, Eighth Circuit, 1963; Kellems v. United States, 97 Fed. Supp. 681, District of Connecticut, 1951.

I pause briefly to say something about the [709] require of wilful. The term as used in this section to which I referred means intentionally, knowingly and voluntarily. Neither fraud nor bad motives are necessary to the imposition of liability for penalties upon a corporate officer.

Bloom v. United States, 272 Fed. 2d 215, Ninth Circuit, 1959. Cert. denied 363 U.S. 803, 1960; Frazier v. United States, 304 Fed. 2d 528, Fifth Circuit, 1962; Schweitzer v. United States, 193 Fed. Supp. 309, District of Nebraska, 1961.

And it has been held that since fraud is not an element of liability under Section 2707(a), the burden of proof on the question of wilfulness, as upon all other elements in this case, is upon the plaintiff.

Kellems v. United States, supra and Schweitzer v. United States, supra.

Naturally I am basing my determination of these motions on the testimony most favorable to the parties. I therefore conclude that I must grant the motion of the United States with respect to Kalb; and, furthermore, I grant the motion of the United States as to Herold.

This means that I now direct a verdict in favor of the Government with respect to these claims of Kalb and the claims of Herold and counsel for the Govern-[710]ment are to submit a proposed judgment in accordance herewith. That is all.

Ask the jurors to come in.

MR. ANDERSON: Will you entertain a request in case there is a reversal, to prevent a completely new trial, to at least let the case go to the jury and to enter this judgment on the verdict of the jury?

THE COURT: I don't know what you mean. You will have to make plain what you mean.

MR. ANDERSON: Your Honor, I think to save the time of the Court, of the case which has been tried —

THE COURT: You mean I should submit, if it is reversed, to a jury upon the record or decide on the record?

MR. ANDERSON: Your Honor, the Government has only about a half hour's testimony at the most.

THE COURT: They will be, of course, entitled to submit it.

MR. ANDERSON: I would suggest and plead with the Court that we take this testimony and submit the case to the jury because I do think —

THE COURT: What jury?

MR. ANDERSON: Submit the case today to this jury.

[711] THE COURT: No, I decline to do that. I don't think there is any merit in that I must say. If it is reversed if there is an appeal, and it is reversed, then it will depend upon what the direction of the Court of Appeals is. There is nothing to preclude a stipulation at that time, if it is agreed upon by all parties, that the testimony either be considered or read.

MR. ANDERSON: I believe there are a number of cases in this Circuit which indicate that in case of a directed verdict that the case, it is preferable that the case go to the jury after the tremendous expenditure of time and effort and let the jury reach a decision and then —

THE COURT: I don't think it is necessary. I think that the Government here is entitled to the grant of a motion to the effect that Kalb and Herold have not presented sufficient facts to warrant any alteration. No, I don't know what I should do. If you have any memorandum on it, I am not going to submit to them today. That is the purpose of the motion. The purpose of such motions is to end the trial. It isn't just an experiment. I decline to do anything at this time unless counsel for the Government suggests anything.

MR. HARRIS: No, your Honor, we would oppose it.

[712] THE COURT: You agree with what I said?

MR. HARRIS: Yes, your Honor.

THE COURT: All right, that is it.

Proceed to call the jury in.

MR. EISENSTAT: For the record, I join with Mr. Anderson's request.

THE COURT: What you are saying to me in effect is that, of course, I should reserve on this thing and I don't reserve.

MR. ANDERSON: Yes, that is correct.

THE COURT: I am not reserving, this is final with me.

(Jury present.)

THE COURT: To the jurors I wish to inform you that I have decided that as a matter of law I must determine the case as far as my view in favor of the United States, both as to Kalb and as to Herold.

I want to say that the case has been very vigorously submitted by all attorneys, by Mr. Eisenstat and Mr. Anderson and by the two representatives of the United States, Mr. Wohl and Mr. Harris.

I thank you for listening to the case and you are informed that you are excused for the term.

(Jury left the courtroom.)

[713] THE COURT: Thank you for your courtesy.

MR. HARRIS: Your Honor, just one point as to Mr. Steelman.

THE COURT: I will take that up with you and counsel for Steelman.

I will fix a date for a conference and see what we can do to facilitate some disposition of it.

MR. HARRIS: Very well, your Honor.

— —

APPENDIX B

(Filed June 18, 1973)

70 Civ. 5726 (RHL)

#73,539

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

RONALD J. KALB,

Plaintiff,

-against-

UNITED STATES OF AMERICA,

Defendant.

UNITED STATES OF AMERICA,

Third-Party Plaintiff,

-against-

MORRIS STEELMAN and JEROME L. HEROLD,

Third-Party Defendants.

Appendix B

Judgment

This action having come on for trial before this Court, Honorable Richard H. Levet presiding, on the 21st day of May, 1973, and the issues having been duly tried, and the government having moved for a directed verdict at the close of the case presented by plaintiff Roland J. Kalb and third-party defendant Jerome L. Herold, and the Court having granted a said motion.

NOW, upon the annexed affidavit of Assistant United States Attorney Joel B. Harris and on the motion of Whitney North Seymour, Jr., United States Attorney for the Southern District of New York, attorney for the United States of America, it is hereby

ORDERED, ADJUDGED AND DECREED that defendant and third-party plaintiff, United States of America, have judgment against plaintiff, Roland J. Kalb, dismissing the complaint herein, and it is further

ORDERED, ADJUDGED AND DECREED that defendant and third-party plaintiff, United States of America have judgment against third-party defendant, Jerome L. Herold, dismissing his counterclaim herein; and it is further

ORDERED, ADJUDGED AND DECREED that defendant and third-party plaintiff, United States of America have judgment against plaintiff, Roland J. Kalb, on its counterclaim, for the sum of $159,396.37, together with interest thereon in the amount of $40,148.66, and together with costs

and disbursements in the sum of $85.84, amounting in all to the sum of $199,630.87, and that the United States have execution therefor; and it is further

ORDERED, ADJUDGED AND DECREED that defendant and third-party plaintiff, United States of America, have judgment against third-party defendant, Jerome L. Herold, on its third-party complaint, for the sum of $159,396.37, together with interest thereon in the amount of $40,148.66, and together with costs and disbursements in the sum of $85.84, amounting in all to the sum of $199,630.87, and that the United States have execution therefor.

Dated: New York, New York

June 18th, 1973

s/ Richard H. Levet
U. S. D. J.

Judgment Entered: June 18, 1973

s/ Raymond F. Burghardt
CLERK

APPENDIX C

(Filed October 15, 1974)

United States Court of Appeals

for the Second Circuit

Nos. 741, 742

September Term 1973

(Argued April 3, 1974 Decided October 15, 1974)

Docket Nos. 73-2222, 73-2256

Roland J. Kalb,

Plaintiff-Appellant,

v.

United States of America,

Defendant and Third-Party Plaintiff-Appellee,

v.

Jerome L. Herold,

Third-Party Defendant-Appellant.

Appendix C

Before: Hays and Oakes, Circuit Judges;
Christensen, District Judge.*

Appeal from orders entered in the United States District Court for the Southern District of New York, Richard H. Levet, *Judge*, dismissing complaint of appellant Kalb and counterclaim of appellant Herold and directing verdict for appellee in action pursuant to 26 U.S.C. §6672 (1970).

Affirmed as to appellant Kalb, reversed and remanded as to appellant Herold.

Samuel M. Eisenstat, New York, New York (J. Michael Gottesman and Eisenstat & Gottesman, P.C., New York, New York, on the brief), *for Appellant Kalb.*

Eugene R. Anderson, New York, New York (Anderson, Russell & Kill, P.C., New York, New York, on the brief), *for Appellant Herold.*

Joel B. Harris, Assistant United States Attorney (Paul J. Curran, United States Attorney for the

* Honorable A. Sherman Christensen of the United States District Court for the District of Utah, sitting by designation.

Appendix C

Southern District of New York, and Gerald A. Rosenberg, Assistant United States Attorney, on the brief), *for the Appellee.*

HAYS, *Circuit Judge:*

In April 1969 the IRS assessed appellants $163,613.35 in penalties pursuant to 26 U.S.C. §6672 (1970) for failure to collect and pay over to the United States taxes withheld from employees of Herold Radio & Electronics Corp. for various periods in 1959, 1960, and 1961. Appellant Kalb paid part of the assessment and then commenced an action for a refund of the payment. The United States counterclaimed for the unpaid part of the assessment. Later the United States commenced a third-party action against appellant Herold and another officer of Herold Electronics. Herold counterclaimed for his partial payment of the assessment. After introduction of evidence by all parties the district court granted the motion of the United States to dismiss Kalb's claim and Herold's counterclaim and to direct a verdict for the United States on its counterclaim and third-party claim.

We find that there was a triable issue of fact as to whether Herold's failure to pay was "willful" within the meaning of section 6672. We therefore reverse and remand as to him. In all other respects we affirm the judgment of the district court.

Appendix C

I.

In 1949 appellants and one Morris Steelman formed a business to manufacture radios and phonographs. In 1955 they revised the corporate structure of the venture, making Herold Radio the parent company with Steelman Phonograph Company and Roland Radio Company as subsidiaries.

In 1959 the company's financial condition began to deteriorate. The Bankers Trust Company, which had provided financing for the business, threatened to withdraw its line of credit. The parties reached an agreement whereby financing continued on the condition that the bank was permitted to place a representative on Herold Radio's premises to oversee the company's financial operations.

In the ensuing period the bank and the company tried to keep the latter financially viable by paying only the company's most persistent creditors and deferring others. Although the company continued to withhold taxes from its employees, it did not pay over these taxes to the government.

The efforts to save Herold Radio failed. In January 1961 the company ceased operations with the withholding taxes still unpaid.

Pursuant to 26 U.S.C. §6672[1] (1972) the government then assessed appellants for the full amount of the unpaid taxes.

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1. The statute provides:

"Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect

(Cont'd)

Appendix C

II.

Appellant Herold claims that under 26 U.S.C. §6501 (1970) the statute of limitations ran as to him for the first quarter of 1961. The return was filed after the company's bankruptcy and was not signed. Generally an unsigned return does not start the statute of limitations running. *Lucas v. Polliod Lumber Co.*, 281 U.S. 245, 248-49 (1930); *Doll v. Commissioner*, 358 F.2d 713 (3d Cir. 1966).

Herold seeks to distinguish his case on the ground that it was not his return and that he was not aware it was unsigned. He offers no authority for his position.[2] Although the return was not personal, Herold was responsible for it, see part V infra. We find no reason to remove this case from the general rule that the statute does not run while the return remains unsigned.

(Cont'd)

> such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable."

2. The two cases advanced by appellant clearly differ from the instant case. In *Miller v. Commissioner*, 237 F.2d 830, 837 (5th Cir. 1956), the court held that the IRS could not claim that for purposes of the statute of limitations the return was unsigned when the taxpayer's wife had signed taxpayer's name in accordance with his directions. In *Adbern Co. v. Commissioner*, 120 F.2d 424, 427 (4th Cir. 1941), the court held in essence that the IRS was estopped from claiming that the return was unsigned because the infirmity was induced by the actions of its own agent. Neither holding supports appellant's position.

Appendix C

Herold also claims that he is not liable for taxes withheld in the second and third quarters of 1960 because the taxes did not become due until August 15, 1960, on which date the company filed a petition under Chapter XI of the Bankruptcy Act. Herold argues that in those circumstances payment of a pre-existing debt was impermissible as a matter of law. However, withholding taxes are not simply a debt. They are part of the wages of the employee, held by the employer in trust for the government. 26 U.S.C. §7501(a) (1970). In paying the taxes over to the government the employer merely surrenders that which does not belong to him. We know of no rule prohibiting such payments by a petitioner under Chapter XI.

Herold also contends that he is not liable for the penalty for the first quarter of 1961 because the company went bankrupt on January 14, 1961, at which time the payments for the first quarter were not yet due. The fact that the taxes were not yet due is irrelevant. As the employer withholds taxes from employees' wages a contingent liability is created. The liability merely becomes fixed on the due date. See *In re Serignese,* 214 F. Supp. 917, 920 (D. Conn. 1963), aff'd sub nom. *Goring v. United States,* 330 F.2d 960 (2d Cir. 1964 (mem.). Again, appellant shows no authority for the claim that payments of these funds held in trust are prohibited by law. Even adjudication as a bankrupt does not discharge liability for taxes withheld from employees. Bankruptcy Act §17(a)(1)(e), 11 U.S.C. §35(a)(1)(e) (1970).

The filing of the Chapter XI petition and the subsequent bankruptcy of Herold Radio therefore do not excuse non-payment.

Appendix C

III.

Both appellants claim that Herold Radio requested the IRS to apply an overpayment arising from the company's net operating loss in 1960 to reduce its withholding tax liability, that the IRS wrongfully refused to honor that request, and that if the loss is so applied it will eliminate appellants' liability.

26 U.S.C. §6402(a) (1970) clearly gives the IRS discretion to apply a refund to "any liability" of the taxpayer. Kalb claims that the IRS did not have this discretion here because the overpayment was voluntary. Although in other areas of the law a payor may have power to direct application of voluntary payments, we find no basis for such power in tax law. Cf. *United States v. Rochelle,* 363 F.2d 225, 232-33 (5th Cir. 1966); *Jewel Shop, Inc. v. United States,* 352 F.2d 526, 530 (Ct. Cl. 1965); *Horwitz v. United States,* 339 F.2d 877, 878 (2d Cir. 1965).

Herold argues that even if the IRS properly refused to apply the overpayment to the withholding tax liability, his reasonable belief that it would be so applied negates the allegation that he willfully failed to pay the tax. The Fifth Circuit has recognized an exception of "very limited application" to section 6672 where there is "reasonable cause" for the willful failure to pay over withholding taxes. See *Newsome v. United States,* 431 F.2d 742, 746-47 & n.11 (5th Cir. 1970). Other circuits have explicitly rejected the "reasonable excuse" exception. See *Monday v. United States,* 421 F.2d 1210, 1216 (7th Cir.), cert. denied, 400 U.S. 821 (1970).

Appendix C

In this case the government at no time indicated that the overpayment would be applied to the withholding tax liability. Attorneys for the company petitioned the referee in bankruptcy for such relief, but neither the referee nor the government ever suggested the relief would be granted. Thus any assumption by appellants that the overpayment would be applied to the withholding tax liability was totally unjustified.

IV.

Appellant Herold raises several claims as to the constitutionality of section 6672. None has any merit.

First, he claims that section 6672 imposes criminal penalties and that it was therefore unconstitutional to apply it without extending to him the rights enjoyed by criminal defendants. The statute essentially provides penalties for breach of that trust imposed by 26 U.S.C. §7501(a) (1970) when an employer fails to pay to the government taxes withheld from the wages of employees. Thus the penalty imposed is civil in nature. *Monday v. United States,* supra; see *Botta v. Scanlon,* 314 F.2d 392, 393 (2d Cir. 1963).

Herold argues that the assessment procedure denied him due process because he was not afforded a hearing before the penalty was levied. It has long been held that collection of taxes by summary proceedings, with judicial review afforded after assessment, does not violate due process. See *Phillips v. Commissioner,* 283 U.S. 589, 595 (1931). Only recently the Court expressly recognized that collection of taxes is one of the

exceptions to the requirement of a prior hearing. *Fuentes v. Shevin*, 407 U.S. 67, 92 & n.24 (1972).

V.

Appellants claim that they were not "responsible persons" and did not willfully fail to pay taxes within the meaning of section 6672.

First, they claim that during the relevant period Bankers Trust Company controlled Herold Radio's finances and prevented appellants from paying withholding taxes. They allege that they always included taxes in the list of debts forwarded to the bank for approval of payment, but that the bank refused to approve payment. The government contests the allegation, but even if it were true it would not absolve appellants because it is undisputed that appellants voluntarily entered into and at all times acceded to the arrangement.

Appellants concede that any power the bank may have had to select which creditors should be paid was granted by appellants as part of the consideration for the bank's continuing financing of Herold Radio. Appellants maintained legal control of the company, including the power to sign checks. Appellants were always free to rescind the agreement if it involved them in breaches of their duties under section 3402(a).

To permit corporate officers to escape liability under section 6672 by entering into agreements which prefer other creditors to the government would defeat the entire purpose of

the statute. As we have noted, and as section 7501(a) makes explicit, withholding taxes are held in trust. We cannot imagine that in any other context a trustee could avoid his obligations by entering into an agreement by which funds entrusted to him are used to pay his other obligations. Similarly, we will not permit appellants so to escape their obligations here. Cf. *United States v. Hill*, 368 F.2d 617, 620-22 (5th Cir. 1966); *United States v. Strebler*, 313 F.2d 402, 404 (8th Cir. 1963); *Bloom v. United States*, 272 F.2d 215, 222-23 (9th Cir. 1959), cert. denied, 363 U.S. 803 (1960).

The only remaining question is whether Kalb and Herold were "responsible persons" and whether they "willfully" failed to pay taxes.

Under section 6672 a responsible person is "[a]ny person required to collect, truthfully account for, and pay over" the relevant tax. 28 U.S.C. §6672 (1970). Except to the extent that he relies on the arrangement with the bank, Kalb hardly denied that he was a responsible person. Kalb was the Chairman of the Board and chief executive officer of the company. S. Freedland, the company's controller and head of its accounting department, was responsible to Kalb. It was Kalb who negotiated the agreement whereby Bankers Trust continued to finance Herold Radio. In general, the evidence amply demonstrated that Kalb held ultimate authority over the company's financial affairs and was clearly a "responsible person."

As to Herold the evidence is less overwhelming but still justified a directed verdict on the issue of responsibility. He was

president of the company, a major stockholder, and he participated in discussions by the board concerning the company's financial condition and tax problems. He signed checks, including on occasion checks to the IRS, and he signed some of the company's tax returns. Although his involvement in the financial affairs of the company was not as great as Kalb's, it was sufficient to make him a responsible person.

Nor is there any substantial question that Kalb's failure to pay was willful. He not only knew of but negotiated the arrangement with the bank under which other creditors were preferred to the government. He participated in the arrangement by signing checks while knowing that withholding taxes were not being paid.

As to Herold, however, a rather different situation exists. He claims that he did not know that withholding taxes were not being paid. He contends that he became president of the corporation through the historical accident that Herold Radio became the parent company when the three constituent companies merged in 1955, that in substance he was only the purchasing agent for the company, and that he had little understanding of financial matters. He also claims that payment of the corporation's taxes was handled by others, a not untenable claim since Herold Radio was a fairly large organization, employing 800 workers at its peak.

In the district court and in this court the government does not deny Herold's claim, but argues that because of his official capacity he had a duty to know about the arrearage in

withholding taxes. A corporate officer acts "willfully" within the meaning of section 6672, the government argues, when he should have known that taxes owed were not paid. We cannot agree. Conduct amounting to no more than negligence is not willful for purposes of §6672. *Dudley v. United States,* 428 F.2d 1196, 1200 (9th Cir. 1970). It is, however, not necessary that evil motive or intent to defraud be proven in order to establish willfulness. *Monday v. United States,* 421 F.2d at 1216; *Bloom v. United States,* 272 F.2d at 223. *Monday* defined willful action under §6672 as "voluntary, conscious and intentional — as opposed to accidental — decisions not to remit funds properly withheld to the Government." 421 F.2d at 1216. That definition has been widely accepted. *Dudley v. United States,* 428 F.2d at 1198 n.3. *See, e.g., Spivak v. United States,* 370 F.2d 612, 615 (2d Cir.), cert. denied, 387 U.S. 908 (1967). *Monday* also points out, as has to be the case, that willful conduct "may indicate a reckless disregard for obvious or known risks." 421 F.2d at 1215. Willful conduct also includes failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government. *United States v. Leuschner,* 336 F.2d 246 (9th Cir. 1964); *Dougherty v. United States,* 327 F. Supp. 202 (D.S.D. 1971), aff'd without opinion, 471 F.2d 656 (8th Cir. 1972). *See Burack v. United States,* 461 F.2d 1282 (Ct. Cl. 1972).

This case must therefore be remanded for determination of whether Herold, a responsible person under §6672, "willfully" failed to see to it that the withheld taxes were paid over to the rightful payee, the Internal Revenue Service.

APPENDIX D

(Filed October 15, 1974)

73-2256
73-2222

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the fifteenth day of October one thousand nine hundred and seventy-four.

Present:

HON. PAUL R. HAYS

HON. JAMES L. OAKES
Circuit Judges

HON. A. SHERMAN CHRISTENSEN
District Judge

Appendix D

Ronald J. Kalb,

Plaintiff-Appellant

v.

United States of America,

Defendant-Appellee

United States of America,

Third Party Plaintiff-Appellee

v.

Morris Steelman and Jerome L. Herold,

Third Party Defendants

Jerome L. Herold,

Third Party Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

Appendix D

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed as to appellant Roland J. Kalb but as to appellant Jerome L. Herold said judgment be and it hereby is reversed and that the action be and it hereby is remanded to said District Court for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellant Roland J. Kalb and in favor of defendant and third party plaintiff-appellee United States of America.

A. DANIEL FUSARO,
Clerk

By Vincent A. Carlin
Chief Deputy Clerk

APPENDIX E

(Filed December 12, 1974)

73-2222
73-2256

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the twelfth day of December, one thousand nine hundred and seventy-four.

Present:

HON. PAUL R. HAYS,

HON. JAMES L. OAKES,
Circuit Judges

HON. A. SHERMAN CHRISTENSEN,
District Judge

(Same Title)

A petition for a rehearing having been filed herein by counsel for the

Upon consideration thereof, it is

Appendix E

Ordered that said petition be and hereby is denied.*

s/ A. Daniel Fusaro
A. DANIEL FUSARO
Clerk

* The word "denied" was omitted from original but is apparent from docket entries.

APPENDIX F

Internal Revenue Code of 1954 (26 U.S.C.)

§6201. Assessment authority

(a) Authority of Secretary or delegate. — The Secretary or his delegate is authorized and required to make the inquiries, determinations, and assessments of all taxes (including interest, additional amounts, additions to the tax, and assessable penalties) imposed by this title, or accruing under any former internal revenue law, which have not been duly paid by stamp at the time and in the manner provided by law. Such authority shall extend to and include the following:

(1) Taxes shown on return. — The Secretary or his delegate shall assess all taxes determined by the taxpayer or by the Secretary or his delegate as to which returns or lists are made under this title.

(2) Unpaid taxes payable by stamp. —

(A) Omitted stamps. — Whenever any article upon which a tax is required to be paid by means of a stamp is sold or removed for sale or use by the manufacturer thereof or whenever any transaction or act upon which a tax is required to be paid by means of a stamp occurs without the use of the proper stamp, it shall be the duty of the Secretary or his delegate, upon such information as he can obtain, to estimate the amount of tax which has been omitted to be paid and to make assessment therefor upon the person or persons the Secretary or his delegate determines to be liable for such tax.

Appendix F

(B) Check or money order not duly paid. — In any case in which a check or money order received under authority of section 6311 as payment for stamps is not duly paid, the unpaid amount may be immediately assessed as if it were a tax imposed by this title, due at the time of such receipt, from the person who tendered such check or money order.

(3) Erroneous income tax prepayment credits. — If on any return or claim for refund of income taxes under subtitle A there is an overstatement of the credit for income tax withheld at the source, or of the amount paid as estimated income tax, the amount so overstated which is allowed against the tax shown on the return or which is allowed as a credit or refund may be assessed by the Secretary or his delegate in the same manner as in the case of a mathematical error appearing upon the return.

(4) Erroneous credit under section 39. — If on any return or claim for refund of income taxes under subtitle A there is an overstatement of the credit allowable by section 39 (relating to certain uses of gasoline, special fuels, and lubricating oil), the amount so overstated which is allowed against the tax shown on the return or which is allowed as a credit or refund may be assessed by the Secretary or his delegate in the same manner as in the case of a mathematical error appearing upon the return.

(b) Amount not to be assessed. —

(1) Estimated income tax. — No unpaid amount of estimated tax under section 6153 or 6154 shall be assessed.

(2) Federal unemployment tax. — No unpaid amount of Federal unemployment tax for any calendar quarter or other period of a calendar year, computed as provided in section 6157, shall be assessed.

(c) Compensation of child. — Any income tax under chapter 1 assessed against a child, to the extent attributable to amounts includible in the gross income of the child, and not of the parent, solely by reason of section 73(a), shall, if not paid by the child, for all purposes be considered as having also been properly assessed against the parent.

(d) Deficiency proceedings. — For special rules applicable to deficiencies of income, estate, gift, chapter 42, and chapter 43 taxes, see subchapter B.

As amended Aug. 7, 1969, Pub. L. 91-53, §2(b), 83 Stat. 92; Dec. 30, 1969, Pub. L. 91-172, Title I, §101(j) (38), 83 Stat. 530; May 21, 1970, Pub. L. 91-258, Title II, §207(d) (1), (2), 84 Stat. 248; Sept. 2, 1974, Pub. L. 93-406, Title II. §1016(a) (8), 88 Stat. 929.

§6203. Method of assessment

The assessment shall be made by recording the liability of the taxpayer in the office of the Secretary or his delegate in accordance with rules or regulations prescribed by the Secretary or his delegate. Upon request of the taxpayer, the Secretary or his delegate shall furnish the taxpayer a copy of the record of the assessment. Aug. 16, 1954, c. 736, 68A Stat. 768.

Appendix F

§6321. Lien for taxes

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person. Aug. 16, 1954, c. 736, 68A Stat. 779.

§6671. Rules for application of assessable penalties

(a) Penalty assessed as tax. — The penalties and liabilities provided by this subchapter shall be paid upon notice and demand by the Secretary or his delegate, and shall be assessed and collected in the same manner as taxes. Except as otherwise provided, any reference in this title to "tax" imposed by this title shall be deemed also to refer to the penalties and liabilities provided by this subchapter.

(b) Person defined. — The term "person", as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs. Aug. 16, 1954, c. 736, 68A Stat. 828.

(2) Federal unemployment tax. — No unpaid amount of Federal unemployment tax for any calendar quarter or other period of a calendar year, computed as provided in section 6157, shall be assessed.

(c) Compensation of child. — Any income tax under chapter 1 assessed against a child, to the extent attributable to amounts includible in the gross income of the child, and not of the parent, solely by reason of section 73(a), shall, if not paid by the child, for all purposes be considered as having also been properly assessed against the parent.

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Appendix F

§6672. Failure to collect and pay over tax, or attempt to evade or defeat tax

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. Aug. 16, 1954, c. 736, 68A Stat. 828.

In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1138

ROLAND J. KALB AND JEROME L. HEROLD, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioners challenge the correctness of the decision below holding that one of them was personally liable for withholding taxes under Section 6672 of the Internal Revenue Code of 1954 because he willfully failed to pay such taxes after he had withheld them from employees' wages.[1]

The pertinent facts are as follows: During 1959 through 1961, petitioners were officers and directors of Herold Radio & Electronics Company (Pet. App. C 33a-34a; I-R. 103a).[2] Kalb was the chairman of the board and chief executive officer and Herold was the president of the company (Pet. App. C 33a-34a; I-R. 103a, 186a; II-R. 472a).

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[1]The court of appeals reversed the judgment of the district court with respect to petitioner Herold and remanded the case to the district court to determine whether Herold's failure to pay over withheld taxes was willful. It would therefore appear that the petition is premature as to Herold.

[2]References to "I-R." and "II-R." are to the two-volume record filed in the court of appeals.

In 1959, the company encountered financial difficulties, and the bank which had supplied the company with financing threatened to withdraw its line of credit. An agreement was reached in which the bank would continue the line of credit on the condition that the bank be permitted to place a representative on the company's premises to oversee the company's financial operations. During the period the bank's representative was on the premises, payments were made only to the company's most persistent creditors and, although the company continued to withhold taxes, these taxes were not paid over to the government. Efforts to improve the company's deteriorating financial condition were not fruitful. When the company ceased operations in 1961, its withholding taxes were still unpaid (Pet. App. C 27a; II-R. 749a).

In April, 1969, pursuant to Section 6672, the Internal Revenue Service assessed $163,613.35 in penalties against each of the petitioners on the ground that each was a person required to collect and pay over withholding taxes who had willfully failed to do so with respect to wages of employees of the company for various periods during 1959, 1960 and 1961 (Pet. App. C 26a; II-R. 748a). Kalb paid part of the assessment and then commenced this refund suit, and the government counterclaimed for the balance of the assessment and filed a third-party complaint against Herold. Herold also paid part of the assessment and then counterclaimed for his partial payment. The district court, after the presentation of evidence to the jury, dismissed Kalb's claim and Herold's counterclaim and directed a verdict for the United States on its counterclaim and third-party claim (Pet. App. C 26a). The court of appeals affirmed the district court's judgment as to Kalb. However, the court of appeals, while affirming that Herold was responsible for the collection and payment of withholding taxes, re-

versed the judgment and remanded the case for a determination whether Herold's failure to pay over the taxes was willful under Section 6672.

1. Although petitioners argue (Pet. 10-11) that they were deprived of their right to a jury trial under the Seventh Amendment, they did in fact have a jury trial. Here, the district court directed a verdict for the government on the basis of its view that, on the evidence and in light of the applicable legal principles, the jury could not return a verdict for petitioners. That action was an appropriate exercise of the court's authority, in order to insure that the jury consider only disputed issues of fact. See *Galloway* v. *United States*, 319 U.S. 372, 396. The correctness of the trial court's view that the evidence could not support a verdict for petitioners is not an appropriate matter for review by this Court. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

2. Petitioners further contend (Pet. 13) that their withholding tax liability should have been eliminated because they had directed that an income tax overpayment made in connection with the corporation's 1960 tax year be applied against the deficiency in withholding taxes and that the government had no right to apply it instead to other excise tax liabilities of the corporation. But Section 6402(a) of the Code provides that the Commissioner may credit an overpayment to any tax liability of the overpayor. 10 Mertens, *Law of Federal Income Taxation* (1970 rev.), Section 58.27, relied upon by petitioners (Pet. 13), does not support their position since it deals with funds voluntarily paid and not with the application of overpayments by a taxpayer. Indeed, the pertinent reference in Mertens, *supra*, at Section 58.38, which deals with the crediting of overpayments, states that the Commissioner may credit an overpayment as he sees fit.

Even if the Commissioner was not bound to apply the overpayment as directed by petitioners, they argue (Pet. 11-13) that their belief, on advice of counsel, that it would be so applied, removed the element of willfulness from their failure to pay over the withholding taxes. They urge that *Gray Line Co.* v. *Granquist*, 237 F.2d 390 (C.A. 9), certiorari denied, 353 U.S. 911, where the responsible officer was held not liable under Section 6672 because of reliance upon advice of counsel that certain transportation taxes were not owed to the government, is in conflict with the decision below.

Apart from the fact that petitioners introduced no evidence to support the contention that they received such legal advice, petitioners' failure to collect and pay over the withholding taxes could not possibly have rested upon any expectation that the government would honor the request as to application of the overpayment. By letter dated August 9, 1960 (II-R. 760a) the corporation requested the Internal Revenue Service to use the overpayment first to pay already existing withholding tax deficiencies and to apply the balance against its excise tax liabilities, which were also overdue as of that date. But petitioners' failure to pay over the withholding taxes referred to in the letter had occurred prior to the discovery of the overpayment and the August 9, 1960, request. Petitioners' failure to pay the withholding taxes was either willful or not at the time the default occurred.

Thus, the after-discovered availability of the overpayment cannot alter the fact that the original default was the result of petitioners' willful failure to discharge their duties as responsible persons. At all events, petitioners cannot seriously claim reliance upon the overpayment with respect to withholding taxes required to be collected and paid

over after August 9, 1960, since the express direction in the letter of that date was to use any balance to pay excise taxes of their corporation. Hence, *Gray Line* is distinguishable on its facts.[3]

3. Contrary to petitioners' assertion (Pet. 13-16), the liability that Section 6672 imposes is not criminal (although the statute uses the term "penalty"). It provides for civil recovery by the government, from the person upon whom the statute imposes a fiduciary responsibility, of amounts which should have been paid over to the government and which it lost through that person's willful breaching of his fiduciary duties. *Monday* v. *United States*, 421 F.2d 1210 (C.A. 7), certiorari denied, 400 U.S. 821; *Braden* v. *United States*, 442 F.2d 342 (C.A. 6), certiorari denied *sub nom. Bonistall* v. *Braden*, 404 U.S. 912; *Cash* v. *Campbell*, 346 F.2d 670 (C.A. 5); *United States* v. *Molitor*, 337 F.2d 917 (C.A. 9); *Botta* v. *Scanlon*, 314 F.2d 392 (C.A. 2).[4]

4. Finally, petitioners urge (Pet. 16-18) that the assessment procedure applied in this case is unconstitutional. Section 6671(a) (26 U.S.C.) provides that the penalties provided by Subchapter B (including Section 6672) "shall be assessed and collected in the same manner as taxes." It has long been settled that collection of taxes by summary administrative proceedings prior to hearing does not violate the taxpayer's right to due process, as long as there is a post-seizure opportunity for a judicial hearing. *Phillips*

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[3]In *Haywood Lumber and Mining Co.* v. *Commissioner*, 178 F.2d 769 (C.A. 2) (Pet. 13), the issue was whether there was reasonable cause for the taxpayer's failure to file certain required reports. Taxpayer's accountant had provided the assistance before the acts in question and the reporting failures were found to have been directly attributable to the negligence of the accountant.

[4]That the penalty is not criminal is amply evidenced by the fact that it is applied only to the extent of the government's loss. See *Monday* v. *United States, supra*; *Newsome* v. *United States*, 431 F.2d 742 (C.A. 5).

v. *Commissioner*, 283 U.S. 589. See also *Fuentes* v. *Shevin*, 407 U.S. 67, 91-92. This proceeding provided just such a post-seizure judicial hearing.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

APRIL 1975.

COURT, U. S.

FILED

MAY 10 1975

MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1138

ROLAND J. KALB and JEROME L. HEROLD,

Petitioners,

—v.—

UNITED STATES OF AMERICA,

Respondent.

REPLY MEMORANDUM FOR PETITIONERS

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REPLY MEMORANDUM FOR PETITIONERS

The memorandum of the United States in opposition (herein "Memorandum") inadvertently contains factual errors.

1. The Memorandum (p. 2) states that "the Company continued to withhold taxes * * *". The record is clear that the bank advanced only net payrolls and that there was, in fact, no withholding.

2. The Memorandum states (p. 4) that petitioners introduced no evidence to support the contention that petitioners received professional advice that the overpayment of income tax would offset the withholding tax liability. Kalb testified that he believed that the income tax carryforward would be so applied. Herold Ex. 31 id. was prepared by the Company's attorneys and is a Notice of Motion and Petition to Reduce Claim dated November 10, 1960, requesting that the income tax overpayment be

applied to "withholding and F.I.C.A. taxes". While this is after the date the withholding taxes were due, it shows that the attorneys for the Company also believed the overpayment of income taxes would be applied to withholding and F.I.C.A. taxes. Rule 11 F.R.C.P.

3. The accountants' view that the income tax overpayment would be applied to withholding and F.I.C.A. taxes is not, as characterized in the Memorandum (p. 4) "after-discovered". Herold Exs. 9 id, 16 id. and 17 id. show that the accountants were of the view that the overpayment would wipe out the withholding tax liability.

CONCLUSION

The petition for writ of certiorari to the United States Court of Appeals for the Second Circuit should be granted.

May 9, 1975

Respectfully submitted,

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